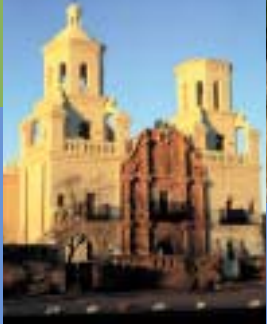


CITY OF TUCSON



SOLUTIONS FOR OUR COMMUNITY: A REGIONAL APPROACH TO THE CITY'S FISCAL CRISIS

FEBRUARY 23, 2004



WRITTEN AND
PRESENTED BY:
THE CITY OF TUCSON
CITIZEN FINANCE
AND SERVICE
REVIEW COMMITTEE

**SOLUTIONS FOR OUR COMMUNITY:
A REGIONAL APPROACH TO THE CITY'S FISCAL CRISIS**
THE CITY OF TUCSON CITIZEN FINANCE AND SERVICE REVIEW COMMITTEE
FEBRUARY 23, 2004

We, the members of the Citizen Finance and Services Review Committee, appreciate the opportunity to address the Mayor and Council. We respect the seriousness of the financial situation that the Mayor and Council are facing with regard the budget shortfall and the need to maintain an acceptable level of services. The Committee has met regularly over the past nine months and has developed this outline of actions that we believe are necessary for the City to take in order to begin economic stabilization and regeneration for our community.

Without immediate action, followed by fundamental change, we see Tucson heading toward a future as a second-rate city at best and almost certain financial collapse at worst. This situation has been in the making for many years. It has been brought about by the combined factors of new development in and around the city, a state revenue sharing system that favors incorporated cities over counties, a local economy that does not generate sufficient wealth to fund our vital infrastructure needs, and a too-prevalent attitude of "business as usual", applying fiscal bandages to systemic problems. If we continue with this attitude, we are a community in jeopardy. We implore you to have a sense of urgency in addressing the City of Tucson's fundamental needs and fostering the collective political will needed to make the tough decisions that will bring about long-term solutions.

These solutions will not come easily, and we empathize with the difficult decisions that lay ahead for the Mayor and Council. We also recognize that these decisions are absolutely essential first steps toward creating a much longer-term strategic plan for the community. These solutions can help form the foundation upon which our community can build economic vitality. We know that you, as the City of Tucson's elected leaders, can start the bold and progressive actions that will move us forward.

Enduring solutions will require a new spirit of cooperation between our local and regional governments. Our metropolitan community's success requires that each of its governmental constituencies contribute with their own economic and community leadership.

Committee Background

The Citizen Finance and Service Review Committee was formed by the City Manager in May of 2003. Members represent a broad cross section of the community (see attachment 1). Tillie Arvizu, Bruce Beach, Fred Boice, Suzanne Bott, Bob Freitas, Mike Hammond, Bill McDermid, Rick Myers, Si Schorr and Marshall Vest have met regularly since the committee's formation to study the City's finance and service challenges, and generate this report. The committee has done a great deal of homework on the details of the City budget and on the pressing fiscal issues the City is facing. We represent diverse interests from within the Tucson community – small businesses, nonprofit organizations, industry, and academe – and we have deliberated carefully over the considerations before you. We have reached a consensus on the recommendations contained in this report, and it is with a unified voice that we present them.

Summary of Recommendations

The committee wants to clearly state that the following recommendations must be considered as a component of a larger overall strategy aimed at solving the City's long-term fiscal issues. The committee supports the steps outlined to address the immediate fiscal crisis only if the fundamental (and admittedly difficult) efforts to address the long-term financial health of the City are also undertaken.

We've included as an attachment a summary of the city's fiscal situation along with other exhibits that provide background information used to generate our recommendations. All information was provided to the committee by the professionals on the City staff.

Fundamental activities required to build our fiscal future:

- Develop options for regional governance by beginning discussions with County officials and local municipalities (pages 5, 6);
- Pursue State legislation to re-empower the Pima Association of Governments as the Regional Transportation Authority for Pima County with appropriate taxing authority (page 6);
- Develop a long-term plan (page 6);
- Examine the services the City provides (page 6);
- Consider consolidating some services with the County (page 6);
- Consider whether the Tucson/Pima Public Libraries (TPPL) should be managed and controlled by the County (page 6);
- Fund 100% of the Tucson/Pima Public Library with the library tax (page 6);
- Seek independent accreditation of services where appropriate (page 6);
- Begin a comprehensive department-by-department efficiency review (page 6);
- Remove the rate cap on the secondary portion of the property tax (page 7);
- Pursue options to recoup the \$60 million in state shared revenue, including simplification changes in State law that governs annexation. Build a strong case to convince citizens that annexation is something that can help the broad community. We must get our \$60 million back into the community (pages 3, 7).

Necessary steps to address the immediate crisis:

- Remove rental and advertising exemptions from the business privilege tax (page 7);
- Transfer services to enterprise operations wherever viable, beginning with Environmental Services (page 8);
- Increase user fees for some municipal services, such as parks and recreation programs (page 8);

- Implement fees for some services, especially residential refuse collection (page 8);
- Enact impact fees on new housing, with the revenue from the fee used ONLY to cover the costs of growth (page 8).

The Fundamental Challenges Facing Tucson

Tucson does not have the taxing or fee structure to provide enough money to pay for the maintenance and improvement of our fundamental infrastructure and the services required by the citizens in the community. The large, growing backlog of necessary capital investments, in an environment where we have difficulty closing the gap in the yearly operating budget, is risking our future ability to provide the services that our citizens require and maintain our vital infrastructure.

If a community is to be viable, local government must provide a basic level of services. A government must provide for the safety of its citizens. It must plan, build and maintain transportation systems. It must plan for the growth and sustainability of the community. These basic government services – public safety, transportation planning, street maintenance, community planning, public libraries, parks and recreation, environmental services – are required for a healthy community.

The facts show that Tucson's infrastructure has been deteriorating and continues to do so. We are reaching a point where it is becoming so expensive to repair our systems that it will be almost impossible to recover; we will always be playing catch-up. As you have been briefed in the past, City streets have \$600 million in deferred maintenance (see Exhibit 2, Tucson's Streets). Arterial streets are pushed past capacity, and the City has about \$3.9 billion in unmet capital improvement needs.¹ Tucson has about 1,000 miles of streets without sidewalks.² The library's new book funding is well below the national average.³ The Tucson Police Department cannot hire new officers due to budget constraints; Tucson is well below national standards for park acreage per resident, and the maintenance on our existing parks has fallen over the last several years, with the Parks Department losing 56 positions over the past two years. The Tucson Fire Department is unable to

meet Arizona's required response times for paramedic response.⁴ The City's remaining bonding capacity is about \$80 million; the existing capital requirements are \$3.9 billion.⁵ Moreover, much of the City's infrastructure is reaching the end of its usable life and will require significant reinvestment and redevelopment in the very near future.

The annual revenue of the City of Tucson is approaching \$1 billion. Yet we do not have the revenue needed to fund basic government services. Over the last nine months, the Finance and Service Review Committee has looked for the root causes of this problem and worked to identify possible solutions.

Throughout the discussions, it has become obvious that attempting to solve the immediate fiscal crisis with short-term, one-time solutions, while ignoring the larger systemic causes will not work.

There are fundamental problems with the way government services are provided and funded in our community. These root causes of the revenue shortage must be fixed if our community is to survive and thrive in the future.

The City's revenue problem is not new; it has been in the making for decades. Throughout the 1990s, the problem was masked by an economy that expanded at one of the fastest rates in history. That economic expansion ended abruptly in early 2001. City revenues, derived largely from the transaction privilege (sales) tax, did not keep pace with the region's population growth. From fiscal year 2002 to fiscal year 2004, City leaders closed a deficit totaling \$127 million. In FY 2005, the City will face an additional funding gap of \$26 million. Comparing fiscal year 2000 to 2004, the City's budget declined \$79 million dollars, when adjusted for inflation and population.

City and other community leaders must act now to resolve the fiscal crisis. If we fail to act, we accept a future of decline for Tucson. If we fail to act, we take a path away from what our people deserve. If we fail to act, we abdicate responsibility.

How Did We Get Here?

The causes of the City government fiscal crisis are numerous and complex. Economists could argue over the interrelationship of the economy, Tucson's tax base, actions at the state legislature, and other factors. The committee has identified what it believes are three systemic issues that must be addressed. Actions that effectively address these fundamental problem areas are required for sustainable solutions.

1. Large unincorporated urban population. Our community's large unincorporated urban population requires two governments to deliver similar services. In Arizona the purposes of city and county governments were once clear and distinct. Counties were charged with being the local implementation arm of the state, with unique responsibility to offer delegated state services, such as indigent health care, while at the same time serving the needs of a rural population. Cities, as independent governments, were responsible for the services needed by a dense, urban population.

However, in Pima County, much of the unincorporated area is urban in nature. Approximately 290,000 Pima County residents live within metropolitan Tucson, but do not live in a city or town. With no municipal government to provide services, Pima County has had to build the capability to provide urban services. And it must do so without the state assistance that incorporated cities and towns receive.⁶

It is unacceptable that our community misses out on approximately \$60 million of State shared revenue each year (see Exhibit 8). This is OUR citizens' money, paid to the State primarily through state income tax. It does not flow back to our metropolitan area because these 290,000 Pima County residents live outside the incorporated boundary of any city or town. Thirty-five percent of Pima County's residents live outside any incorporated area; by contrast, only three percent of Maricopa County residents live outside incorporated areas. The net result is that \$60 million of our taxes go elsewhere. **Over time, we have created a situation where Pima County is forced to charge a higher property tax rate to cover its expenses in the densely populated unin-**

corporated area, and yet our community is not receiving any of the shared state income taxes that these same residents pay (see footnote 6).

Another effect of our government structure is that the revenue streams and taxing authority do not always line up with the government charged with providing a service or with those benefiting from it. The best example of this is the library system. Pima County has the taxing authority for the library district, yet the City contributes half of the funding through its general fund.⁷ When pressure increases on the undesignated portion of the City's general fund budget, funding for the libraries suffers.

2. City's Revenue Base is Inadequate – The City's revenue system is not structured to keep pace with increases in population. Sales tax revenues rise and fall with the economy. The State, not the City, controls State shared revenues. While these revenues may rise or fall, the demand for services constantly grows.

The City has tapped into its fund balance during the past couple of years in order to balance the budget. Good financial practices would have the City maintaining an unreserved fund balance of \$35 to \$50 million. Additionally, the City should have reserves of more than \$60 million. **The City's unreserved fund balance has dropped to \$3.5 million and reserves have dropped to less than \$30 million.**⁸

Our tax system, designed early in the last century, is simply not effective for our future. The Morrison Institute posed the question, "Will the flaws in Arizona's outmoded tax system gradually render the state unable to pay for the public services required?" in its 2001 report, "Five Shoes Waiting to Drop on Arizona's Future."⁹ Substitute "Tucson" for "Arizona" and you have one of the key issues the Finance and Service Review Committee has been grappling with over the last six months.

The City of Tucson is overly reliant on sales tax. Over 43 percent of the revenue that supports the City's general fund comes from sales tax. The problem with sales tax is that its base has not moved forward with the times. In the report, "The Way We Tax," John Mikesell, professor of public finance at

the University of Indiana, states, "We're still pretty close to the taxes that were developed in the 1930s Depression." In 1960, 41 percent of U.S. consumption dollars were spent on services such as those provided by attorneys and accountants. By 2000, it had risen to 58 percent. And yet, only three states – Hawaii, New Mexico and South Dakota – receive a significant portion of revenues from services. In all other states, sales taxes are largely collected on tangible goods, and they are an ever-dwindling share of the total economy.¹⁰

An examination of the business privilege revenue per capita illustrates the problem for our community. Tucson's per capita revenue from the transaction privilege tax (sales tax) decreased more than seven percent from 2001 to 2003.¹¹

Further complicating the revenue situation is the small portion of the City's budget over which City leadership has discretion. Much of the one billion dollar budget for fiscal year 2004 is restricted for specific purposes (see Exhibit 3, "Budget in Brief").

3. Inadequate Regional Approach to Solve Regional Issues – Our City and County elected and appointed leaders have not invested the time to jointly identify the needs of our community. They have not invested the time and effort to coordinate important services for our community from transportation to economic development, and to collaboration between similar departmental functions. Over the last several decades, the City of Tucson and Pima County have attempted local, isolated solutions to regional problems. This approach has been attempted over and over. For example, the City's transportation sales tax initiative, the County's transportation sales tax proposal, one after another, were rejected by voters. City and County development plans are often at odds with each other.

We as a committee do not believe that the fundamental cause of the City of Tucson's fiscal problems is simply that our two largest governments operate independently. We do, however, believe that, as our community leaders look to the future, better cooperation between the City of Tucson and Pima County offers the opportunity for more creative and broad-based actions to address the City of Tucson's needs and the needs of the community as a whole.

Why Now?

These are large, complex, systemic issues that need to be resolved. Because the issues are so complex, the temptation is to avoid action and continue our laissez-faire approach: "The economy will recover, as it always does; the city and county have never gotten along and never will. Why bother?"

Facing a Firestorm

If you take nothing else from our report, take this: We must act now.

The much hoped-for economic recovery will not solve the City's revenue problems. Funding shortfalls for ongoing operations and capital infrastructure improvements are worsened by the weak national economy. However, the poor economy has only underscored the systemic issues of government funding and service provision that have been developing for decades. Taxes and fees must be increased as a fundamental component of long-term solutions for improving the City's fiscal health.

Even though there are signs that the economy is improving, there is a lag time between the economic upswing and actual monetary changes in government revenue. The effects of the 2001 downturn are still being felt in the City, County and State fiscal year 2004 budgets; State shared revenue distributions to cities for 2004 reflect collections from 2001. As the State continues to look for ways to raise revenues to meet the expanding state population and demand for increased levels of service, there will be increasing pressures on unprotected portions of the State budget, including the shared revenue. We cannot rely on an economic recovery or assistance from the State to correct our local situation.

In a recent study of 11 Southwest cities the size of Tucson, Tucson was ranked 9th in average wages and jobs per 1,000 residents.¹² While wealthier communities may be able to survive with these systemic problems, ours cannot.

We must address the root causes and begin repairing the neglected infrastructure now. The threats to our community are every bit as real as the firestorm that

swept through Summerhaven in 2003. If we do not act now, the recovery effort may be insurmountable. We could find ourselves in the same position as Buffalo, New York, declaring bankruptcy for the County and City.

Strategy for a solution: Real solutions must be REGIONAL solutions

The top concern of our committee, and we believe, of our community is the lack of cooperation between the City of Tucson and Pima County governments. There is growing frustration that the City and County do not have a long-range strategy for working together to address the challenges facing the greater community. City and County governments and their respective elected officials consider their constituencies to be separate and distinct. In reality, their constituencies are connected, with shared common needs. Our leaders must approach problems and solutions with a resolute and complete understanding of this connection. City and County staff must provide **a broad-based joint assessment of the needs of our community as well as realistic analysis of potential impact of solutions.** So while the top concern is formidable, it also has the most potential for reasonable, viable solutions.

Some of the most challenging problems for our community can only be solved through a regional approach. Transportation and transit solutions cannot stop at the city limits. Our community needs regional transportation planning and management.

Development and growth-related planning cannot be accomplished independently. Planning needs to be done from the perspective of what is good for the greater community. Approaches to growth-related issues, such as impact fees, need to be consistent across jurisdictional boundaries. Issues such as open space planning and state trust land management need to be addressed as a regional community. Economic development must also be done from a position of combined strength. We must act together to diversify our regional economic base and to attract venture capital and new industry. The region needs to be recognized as unified, progressive, and forward-thinking in order to rise to a new level of prosperity.

The City's elected leaders must look for areas where better coordination and possible consolidation can occur between the City and County. If our community leaders do not create a common vision and purpose, the community will fall to the "divide and conquer" tactics of narrowly focused interest groups, or risk having our future shaped by the loudest voices. City and County elected and appointed leaders need to come together and conduct on-going strategic dialogues. The initial agenda needs to be nothing more than creating a common agenda identifying opportunities for cooperation.

Easing the Fiscal Crisis – A Short-term and Long-term Approach

The recommendations are divided into two categories: those short-term recommendations aimed at relieving the City's immediate fiscal crisis; and the more fundamental actions aimed at resolving the causes of the crisis for the long term.

Fundamental activity required to build our long-term future:

These long-term actions are not an all-inclusive list. We encourage Mayor and Council to evaluate and undertake additional actions to ensure our community's long-term fiscal stability.

- Develop regional governance. The City and County must together pursue having the Arizona State Legislature re-empower the Pima Association of Governments as the Regional Transportation Authority for Pima County with appropriate taxing authority. The recent cooperation among all of our local governments is an outstanding example of stewardship for the best interests of our citizens and should be a foundation for more specific areas of cooperation in the future.
- Develop a long-term plan. The large, growing backlog of capital investment will take many years to address. Therefore, we recommend that the City develop a multi-year plan that sets specific goals and specific time frames for achieving those goals. The plan should identify the costs to achieve the goal and the revenue

plan to fund it. The Mayor and Council have an excellent opportunity with the City's strategic plan. The plan could be modified to include the goals in each area.

- Examine the services. Mayor and Council should examine the City services and decide if the City should continue to provide each service. If the answer is "yes," the City Manager and his staff need to evaluate how best to do so. In some cases, the City is best suited to provide the service; in others, the County is; and still others, private sector assistance may be required.

The Mayor and Council should also:

- Evaluate specific services for consolidation with the County. The City should approach the County now to jointly evaluate combining the parks and recreation services. The functions of the City and County parks and recreation departments for example are very similar, and a consolidated organization could provide a better value to the community.
- Seek outside, independent accreditation of services, where appropriate. The standards for these types of accreditations (ISO 9000, for example) are rigorous and based on industry standards. Internal efforts, such as the City's Good Government initiative, are important, but they need to be coupled with the rigorous processes required to obtain independent industry certification.
- As a companion action to the outside accreditations, the City should begin a ground-up, department-by-department review, similar to the process the Governor has started at the state level. The intent of this effort would be to eliminate unnecessary processes that hurt the efficiency of our City employees, identify and implement best practices (whether they come from government or the private sector), and ensure that we eliminate redundancy of services to our taxpayers.
- Align the funding of the Tucson-Pima Public Library with the taxing authority. Taxing authority for our community's public libraries

resides with the County. City and County officials should begin now to consolidate funding for the libraries so that all funding is provided by the library district tax. This action will relieve pressure on the City's budget, but more importantly, it will provide a dedicated funding stream to help bring our libraries up to national standards.

The following additional steps should be pursued to improve the City's overall fiscal strength:

- Remove the rate cap on the secondary property tax portion of the property tax levy. As discussed earlier, the City's ability to issue general obligation bonds is limited by this cap. Any increase to the secondary property tax rate is tied to a bond issue. Therefore, voters would still decide whether or not to increase the secondary property tax rate as part of the decision on a proposed bond package. Eliminating the cap will allow City officials to present voters with options on the full range of capital improvements, rather than being limited to projects that fit within the current \$80 million capacity.
- Aggressively pursue strategies to recapture the \$60 million in State shared revenue, including annexation. We must recapture taxes our citizens are already paying to the State for our local community. This \$60 million each year is critical to providing the financial resources for our city to build the foundation for economic vitality.

Short-term Actions:

These actions are necessary, but they are merely a triage to slow the "red ink." They must be taken immediately to lessen the crisis and stabilize the budget. However, they **must be** explicitly connected to the larger vision: regional cooperation and problem solving, strengthened regional governance, and purposeful debate about how to best provide government services.

City officials should consider the following steps to stabilize the City's budget:

- Remove rental and advertising exemptions from business privilege tax; the estimated additional revenue is \$16 million per year. The rental tax could be implemented using a sliding scale to ensure it would not be a financial burden to low-income renters.

All Arizona cities and towns that collect a local business privilege tax do so through the Arizona Model Cities Tax Code. This common code provides a standard implementation of the business privilege tax across the state, while allowing local control through specific local exemptions that a city or town may employ. Over the years, the City implemented three exemptions: use tax, residential rentals and advertising. The Mayor and Council voted to discontinue the use tax exemption and began collecting use tax in 2003, leaving the residential rental and advertising exemptions in place.

Only two cities in Arizona exempt residential rentals from sales tax: Flagstaff and Tucson. In Tucson, the decision to implement this exemption may have been influenced by the State property assessment ratio. At the time the City made the decision, the ratio, which determines the taxable value, was 40% higher for residential rental property than for owner-occupied property. This resulted in a higher property tax on rental properties and it was assumed that the property tax would be passed on to the renter. Moreover, a homeowner could claim property tax as an income tax deduction, but there was no corresponding relief for renters.

The State has since equalized the assessment ratios at 10% for both owner-occupied and residential rental property. Renters are also granted an adjustment on their State income tax.

The second significant exemption is the exemption to advertising. Tucson is the only Arizona city that exempts advertising. Prior to 1992, the City imposed the two percent business privilege tax on advertising. Then, in

1992, the Mayor and Council decided to exempt advertising from the tax, phasing the exemption in over two years.

The estimated revenue from residential rentals is \$12.4 million per year; from advertising rentals, \$3.6 million per year.

- Transfer some services to enterprise operations to relieve pressure on the general fund. Specifically, City officials should begin now to evaluate creating an enterprise operation for the Environmental Services Department and charging a fee for residential refuse collection services. Not only would this relieve pressure on the budget, but also it would allow the City to issue revenue bonds for the specific environmental capital improvement projects. The fee must be reasonable and supported by thorough, clearly documented analysis.
- Increase user fees to recoup a greater portion of the service cost for some municipal services. We recognize that setting the fees for some services, such as parks and recreation classes and after school programs, is both a policy decision and a fiscal decision, and any decision to increase fees needs to include both aspects. However, we also believe that there is opportunity to provide an additional revenue stream that could then be used to continue these programs, even when other revenues dip.
- Enact impact fees on new development. The impact fee needs to be based on a detailed, documented analysis of the capital costs associated with that new development. Revenues raised from impact fees should be used specifically for infrastructure improvements required to support the new developments.¹³

Conclusion

We must act now. We must act within the context of the shared vision we have for a vibrant future for our community. We must make decisions and begin actions that will clearly begin the process of rebuilding our city and creating the foundation for our citizens to prosper.

We know that the challenges are great but we believe the Mayor and Council are the leaders who can take the necessary steps to turn the ship around. The citizens need you to start the process of rebuilding our fiscal infrastructure and repairing the results of the years of benign neglect that you inherited when you took office.

We also recognize that this is a shared responsibility. The changes will require a great deal of community support. It is our responsibility to help encourage citizens to get involved, to participate in developing creative solutions and to support what may be difficult actions. We all must be the leaders who begin the region's new era of financial redevelopment and economic prosperity.

It is a challenge, but you are the leaders to address these issues head-on and take the necessary steps toward an economically sound future for Tucson. We, the members of the Finance and Service Review Committee, are honored to have the opportunity to present our findings to you.

Foot Notes

1. \$3.9 billion in unmet capital needs represents about \$3 billion in transportation needs and \$900 million in other general needs, including \$45 million in environmental service-related projects and \$80 million in library projects.
2. Over 60 percent of the City's 1,700 miles of arterial, collector and residential streets do not have sidewalks.
3. In 2003, library's book replacement funding was \$3.07 per capita, compared to a national average of \$5.23 per capita; in 2004, the funding was cut to \$2.90, compared to a projected increase in the national average to \$5.44 per capita. (National averages derived from statistics provided in Statistical Report 2003, Public Library Data Service, Public Library Association.)
4. The Arizona Department of Health Services, Bureau of Emergency Medical Services requires that Tucson Fire Department (TFD) respond within 8 minutes or less for 90 percent of its calls. TFD on-time rate, as reported to the State in November 2003, was 86.6%, a decline from 88.1% in 2002.
5. The City's ability to issue general obligation bonds is limited by a rate cap on the property tax, approved by voters in the 1960s. Because this rate cap limits the revenue that can be raised to service the bond debt, it limits the amount of bonds that can be issued.
6. The State allocates a portion of state revenues (from income tax, gasoline tax, sales tax and other sources), commonly called "state shared revenue," to local governments based on a per capita formula. Cities are provided more per capita than counties. The portion of shared revenues that comes from the state income tax is only distributed to cities and towns.
7. The general fund is the portion of the budget over which Mayor and Council have discretion. It pays for a wide range of basic services such as police, fire, parks and libraries.
8. The reserves include \$22.3 million reserved for environmental mandates and \$3.3 million reserved for critical deferred maintenance needs. Bond rating agencies use the level of reserves as a major rating factor. For the last several years the rating agencies have been critical of the City's low reserves.
9. Morrison Institute for Public Policy, "Five Shoes Waiting to Drop on Arizona's Future," page 3, October 2001.
10. Katherine Barrett & Richard Greene, Michele Mariani and Anya Sostek, "The Way We Tax, A 50-State Report," <http://www.governing.com/gpp/2003/gp3intro.htm>.
11. In constant dollars, the per capita business privilege tax revenue for fiscal year 2001 was \$343.60; for 2003, it was \$317.10.
12. According to the Bureau of Labor Statistics for 2002.
13. State law requires that the impact fee bear a reasonable relationship to the burden imposed upon the municipality to provide additional necessary public services to the development (ARS 9-463.05B4).

Exhibits:

1. Committee Members
2. Tucson's Streets
3. Budget Information
4. Pima County/Maricopa County General Comparison
5. Pima County/Maricopa County Population Comparison
6. 2002 Arizona County Property Tax Rate Comparison
7. 2003 Arizona City Property Tax Rate Comparison
8. State Shared Revenue Calculations
9. Revenue Issues – Charter-mandated Rate Cap On The Secondary Property, Unmet Capital Needs
10. Revenue Issues – City of Tucson Business Privilege Tax Exemptions
11. Revenue Issues – User Fees
12. Residential Garbage Collection Fee – National Trends

Exhibit 1

Citizen Finance and Service Review Committee Members

Tillie Arvizu, Assistant Vice President, Chicanos Por La Causa

Bruce Beach, President, Beach, Fleischman & Co., P.C.

Fred T. Boice, Owner, Boice Financial Company; Member, Arizona Board of Regents

Dr. Suzanne Bott, Project Manager, Building from the Best of Tucson, Sonoran Institute

Bob Freitas, Associate in Extension, Department of Agricultural and Biosystems Engineering, College of Agriculture and Life Sciences, University of Arizona

Mike Hammond, President, PICOR Commercial Real Estate; Vice Chairman, Arizona Town Halls

Bill McDermid, Group Vice President, General Growth Management

Rick Myers, President, Southern Arizona Leadership Council; Participant, 83rd Arizona Town Hall, "The Realities of Arizona's Fiscal Planning Process"

Si Schorr, Senior Partner, Lewis and Roca LLP; Member, Arizona Board of Transportation

Marshall J. Vest, Director, Economic and Business Research, Eller College of Business and Public Administration, University of Arizona; Technical Advisor, Arizona Governor's Citizen Finance Review Commission

Condition of Local Streets

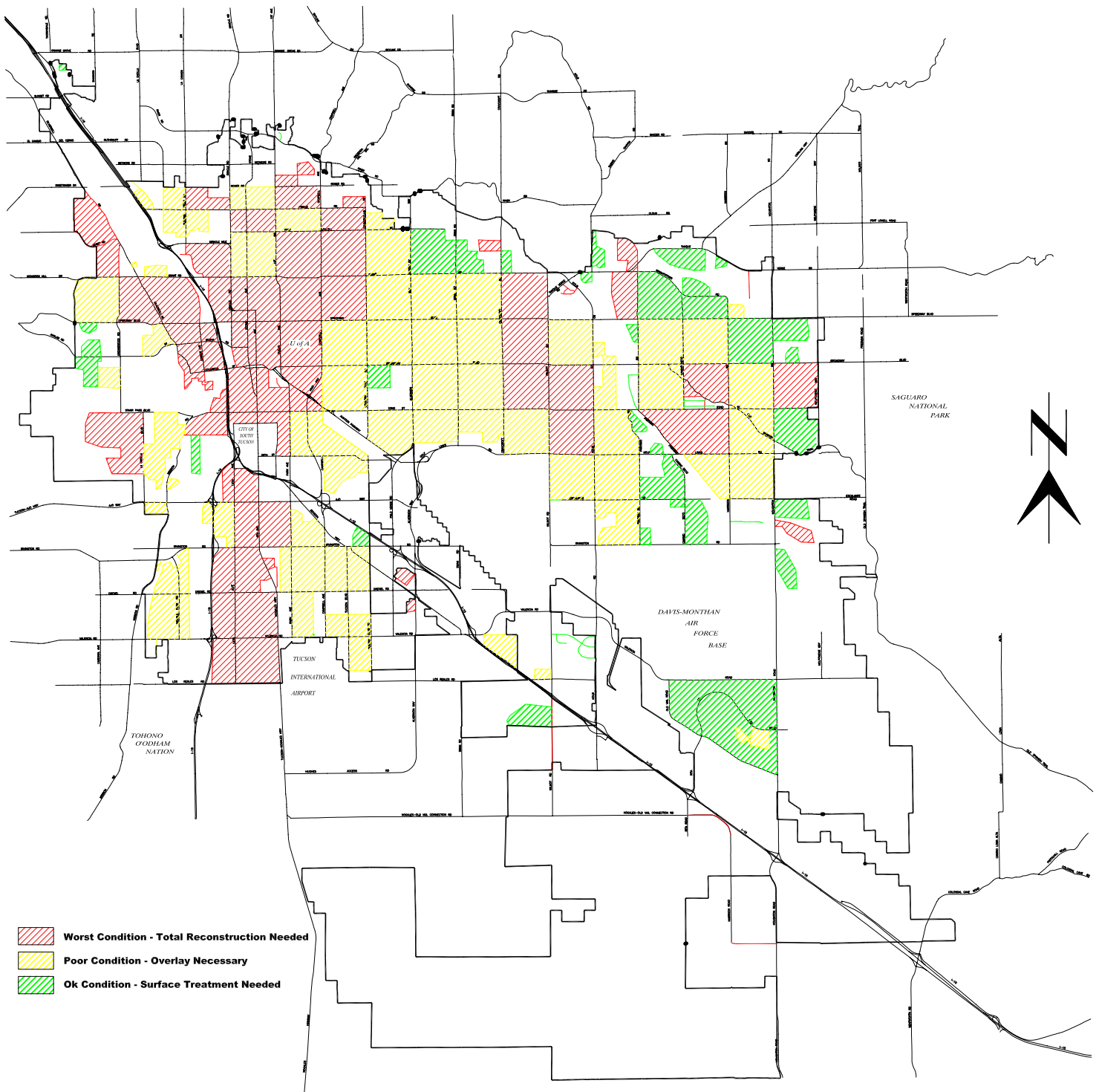


Exhibit 3

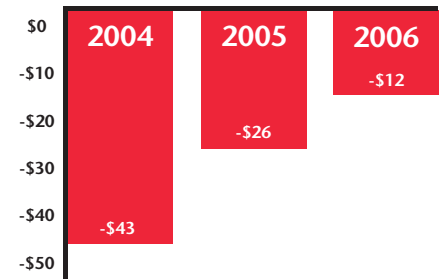
CITY BUDGET IN BRIEF

Tucson is not alone in having to deal with this country's most serious fiscal crisis since World War II. Studies have put Arizona among the states with the most constricted finances. The cascading effect of very tight budgets at the federal, state and local levels have put the City of Tucson in challenging times that will remain with us through Fiscal Year 2006.

Tough choices were made in balancing the budget for the 2004 Fiscal Year. Through a combination of expenditure reductions, revenue increases and employee pay freezes, the City managed to produce a budget to overcome a \$43-million deficit and preserve the core services the City provides. Expenses were cut by approximately \$29 million. A total of 138.5 jobs were eliminated. Some fee increases were implemented to avoid further cuts in services in areas such as Parks and Recreation.

What has become clear is that the City cannot continue to rely solely on revenue sources that fluctuate with the economy. Tucson is the 29th largest city in the nation, but it is funded primarily with a single source of revenue, the sales tax. An economic downturn, such as the one in which the nation finds itself today, is particularly hard on our City because of its lack of revenue diversity.

PROJECTED DEFICITS OVER 3 YEARS
(IN MILLIONS)



THE FISCAL YEAR 2004 BUDGET

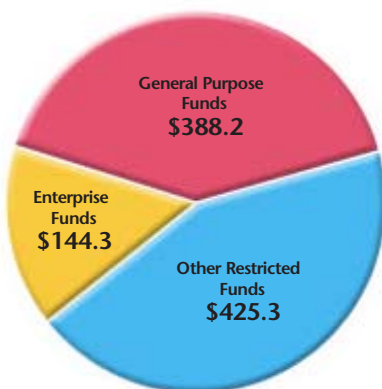
The City's total budget of \$957.8 million is made up of three primary components: General Purpose Funds; Enterprise Funds; Other Restricted Funds.

Enterprise funds are those revenues generated by Tucson Water and Tucson City Golf. Those funds cannot be allocated for general purposes such as police and fire service and other core services.

Restricted funds come from a designated revenue source and have a special purpose. They cannot be spent on anything other than the purpose for which they are allocated. For example, the City receives federal funds for transportation projects which cannot be spent on anything else, even if a more critical need arises in another area of government.

General Purpose Funds pay for a wide range of basic services, including police, fire, parks, libraries, solid waste management and transit.

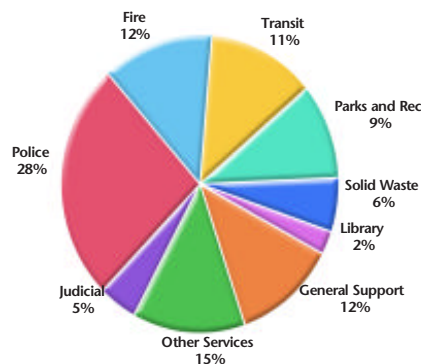
FISCAL YEAR 2004 BUDGET
OF \$957.8 MILLION



THE GENERAL PURPOSE FUND

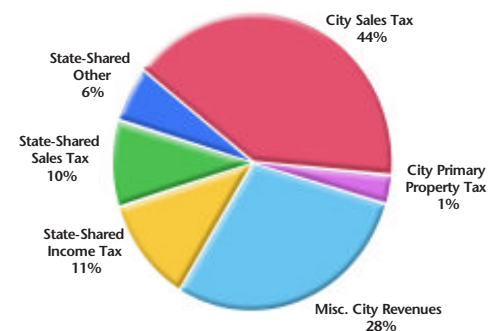
The City's General Purpose Funds budget contains the funds that the Mayor and Council have full discretion to allocate for basic City services. The General Fund budget of \$388.2 million for the 2004 Fiscal Year is less than the 2003 budget. Approximately 74% of this budget is for police, fire, judicial services, parks and recreation, libraries, solid waste and transit.

FY 2004 GENERAL PURPOSE FUNDS BUDGET



Funding that can be used for general purposes comes either from City-generated revenue or state-shared revenue. State-shared revenues for Fiscal Year 2004 decreased by \$8 million from the previous year.

GENERAL PURPOSE FUNDS - REVENUE



PROPERTY TAXES

City property taxes make up only a small portion of the revenue the City receives to pay for services.

On a typical annual property tax bill of \$1,474, the City of Tucson collects \$112, or 8% of the total. Of the amount that goes to the City, approximately \$90 must be used to pay debt on voter-approved capital projects. The remaining amount, approximately \$22 per year, is used to fund City services such as police, fire, garbage collection, parks and libraries. To put that amount in context, it costs the City of Tucson approximately \$150 per year to collect trash from a residence.

YOUR PROPERTY TAXES

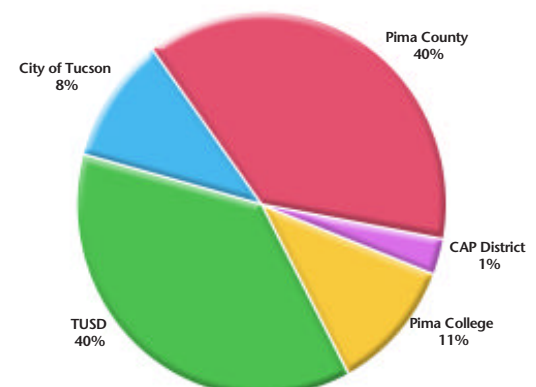


Exhibit 4

**General Comparison:
Pima County and Maricopa County**

	<u>Pima County</u>	<u>Maricopa County</u>
Total Population ('02 Est.)	890,545	3,296,250
Unincorporated Population ('02 Est.)	320,665	225,530
Total Funds Budget (FY 2003)	\$989,567,615	\$2,464,915,690
Total Funds Budget per Capita	\$ 1,111.19	\$ 747.79
Total Funds Budget per Capita:		
Sheriff	\$ 103	\$ 43
Parks and Recreation	\$ 12	\$ 3
Development Services	\$ 10	\$ 3

Exhibit 5

Percent of Population Living in Incorporated Areas Pima County vs. Maricopa County

Pima County is 64% incorporated

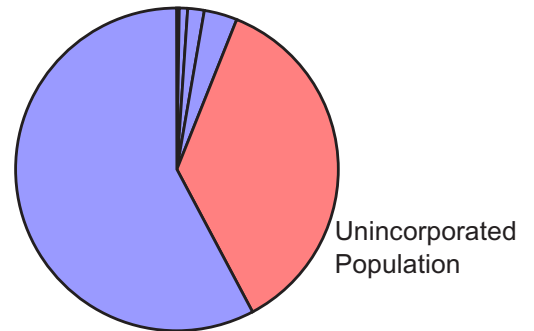
Maricopa County is 93% incorporated

Pima County Total Population 843,746

Pima County Incorporated
Population 538,687

Tucson	486,699
Oro Valley	29,700
Marana	13,556
South Tucson	5,490
Sahuarita	3,242

Incorporated
Population



Maricopa County Total Population 3,072,149

Maricopa County Incorporated
Population 2,860,946

Unincorporated
Population



Incorporated
Population

Source: U.S. Census, 2000

Exhibit 6

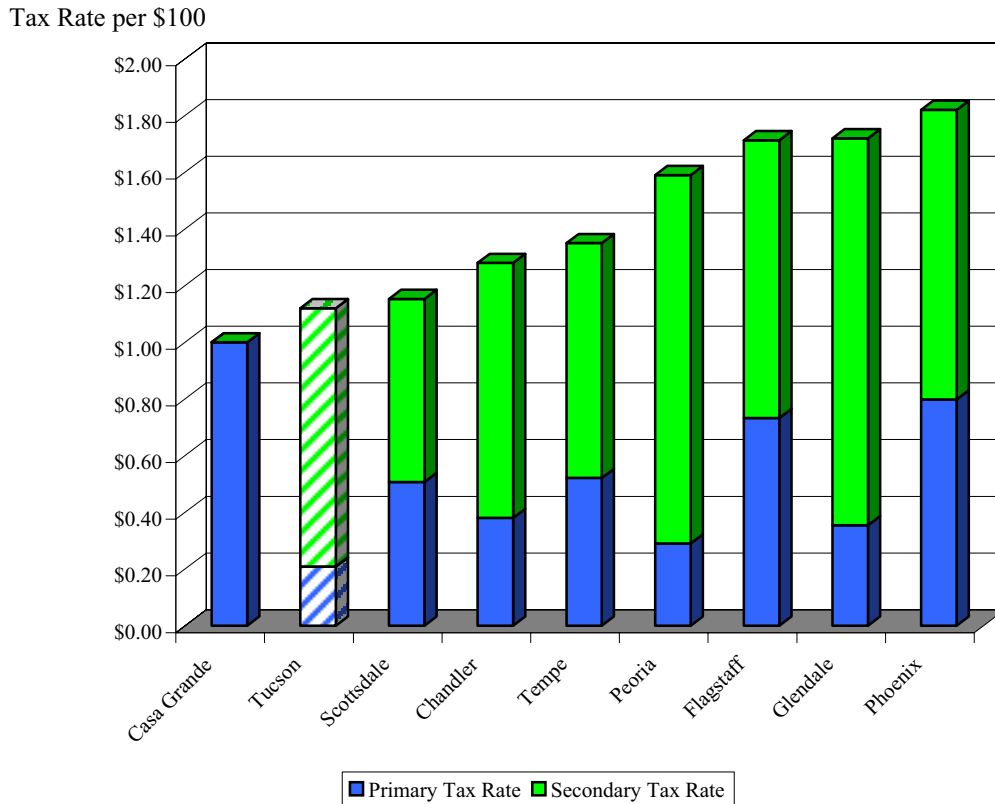
**Arizona County Property Tax Rates
2003**

<u>County</u>	<u>Total Tax Rate (per \$100 of Assessed Value)</u>
Apache	\$0.8274
Cochise	2.9373
Coconino	0.4753
Gila	4.4100
Graham	1.7912
Greenlee	2.0426
La Paz	2.2500
Maricopa	1.2808
Mohave	1.7500
Navajo	0.4772
Pima	4.8870
Pinal	4.5963
Santa Cruz	3.6604
Yavapai	1.6808
Yuma	2.3180

Exhibit 7

PROPERTY TAX RATES FOR SELECT ARIZONA CITIES

Fiscal Year 2002/03
(Tax Rate per \$100 A.V.)



City	Primary Tax Rate	Secondary Tax Rate	Total City Tax Rate
Casa Grande	\$0.9999	\$0.0000	\$0.9999
Tucson	0.2089	0.9113	1.1202
Scottsdale	0.5073	0.6456	1.1529
Chandler	0.3800	0.9000	1.2800
Tempe	0.5214	0.8286	1.3500
Peoria	0.2900	1.3000	1.5900
Flagstaff	0.7326	0.9801	1.7127
Glendale	0.3548	1.3652	1.7200
Phoenix	0.7982	1.0218	1.8200
<hr/>			
Mesa (1)	0.0000	0.0000	0.0000
Marana (1)	0.0000	0.0000	0.0000
Oro Valley (1)	0.0000	0.0000	0.0000

Source: *Property Tax Rates and Assessed Values, Arizona Tax Research Foundation*

(1) The City of Mesa and the towns of Marana and Oro Valley do not currently impose a property tax.

State Shared Revenue

The state distributes a portion of the revenue it collects from the state income tax, state sales tax, vehicle license (auto lieu) tax, highway user revenues, and lottery proceeds to local jurisdictions. These funds provide a large amount of operating revenue for cities, towns and counties.

In Fiscal Year 2003, the City of Tucson received approximately \$159 million (\$307.33 for every person living in the city limits) in State Shared Revenue. **The Tucson metropolitan area would receive approximately \$60 million in additional state shared revenue if the entire population that resides in unincorporated urban areas resided in incorporated jurisdictions.**

Because the State Shared Revenues are a return of taxes to the local area, unincorporated Pima County residents pay state taxes that are distributed elsewhere in Arizona.

The State distributes state shared revenue to cities, towns and counties based on the following method:

- State Income Tax
 - 15% shared with cities and towns (not distributed to counties).
- State Sales Tax
 - 25% of the distribution base is returned to the local community.
 - Distributed to cities, towns, and counties based on population relative to the total incorporated population of the state.
- Vehicle License (Auto Lieu) Tax
 - Cities and towns receive almost 25%
 - Counties receive almost 25% for general purposes and another 6% for highway purposes
- Highway User Revenues (gasoline/diesel taxes and related transportation fees)
 - Cities and towns receive 27.5 % of net state collections; one half is distributed on basis of incorporated population and one half on the basis of county origin of gas sales and city or town population within each county.
 - Phoenix, Tucson, and Mesa receive an additional 3% (cities over 300,000 population).
 - Counties receive 19% based on a portion of gas distribution and diesel fuel consumption and on a portion of unincorporated population (this split is 72/28).
- Local Transportation Assistance Fund (lottery proceeds)
 - Distributed to cities and towns based on population relative to the total incorporated population of the state.
 - Restricted for public transportation operating expenses and related capital purposes

Exhibit 8
Page 2 of 2

The estimated \$60 million in additional revenue is based on the following calculations:

- It is estimated that approximately 290,000 unincorporated Pima County residents live within the nearby metropolitan Tucson area (the entire unincorporated population is 325,425 as of July, 2003).
- By applying the estimated unincorporated Pima County population residing in the metropolitan area to the current State Shared Revenue figure, the result is approximately \$89 million (290,000 X \$307). In reality, however, the \$307 per person figure would drop with the addition of 290,000 people to about \$279 per person because the “pot” would not grow but would be divided among more residents. The resulting figure is approximately \$81 million.
- With annexation, Pima County would see a reduction in the State Shared Revenue that it receives, as the HURF component of State Shared Revenue is calculated based on *unincorporated* population. This would reduce Pima County’s State Shared Revenue by approximately \$20 million. Pima County will receive approximately \$149 million in State Shared Revenue in 2003. All other components of State Shared Revenue for the county are based on total county population, which does not change with annexation.

Additional State Shared Revenue to metro area with incorporation:	\$81 million
Reduction in State Shared Revenue to Pima County with incorporation:	<u>\$20 million</u>
Approximate net increase in State Shared Revenue to our area:	\$60 million

REVENUE ISSUES FOR CONSIDERATION:
Charter-Mandated Secondary Property Tax Cap

Background: In the 1960s, voters authorized an increase to the City's business privilege tax to the current 2 percent. At the same time, they mandated a cap of \$1.75 per \$100 of assessed valuation for the property tax rate. In the past, the property tax rate cap has not been a problem for the City. However, in the recent years it has restricted the City's ability to issue general obligation (GO) debt bonds.

Discussion: The capital improvements identified by the City total \$3.9 billion (see page 2 of this exhibit). The maximum estimated bonding package that could be presented to the voters in the next bond election (scheduled for 2005) is approximately \$80 million.

The reason for this large shortfall is the cap on the property tax rate. In order to maintain a high bond rating and have City securities be treated favorably in the market place, the City property tax rate needs to remain approximately \$.25 below the maximum allowable tax rate. Therefore, the City's effective property tax rate is \$1.50 per \$100 of assessed valuation. Because the rate cap limits the revenue that can be raised to service the GO debt, it limits the bonds that can be issued.

One solution that the committee might explore is to treat the portion of the property tax that supports the GO debt (secondary property tax) separately, eliminating the cap from this portion of the tax.

NOTE: General obligation bonds are used to finance new capital projects or capital improvements to municipal facilities. The typical uses of GO bonds include building a new library or improving park facilities. This type of bond is paid for by the secondary property tax and requires voter approval. General obligation bonds are backed by the full faith and credit of the City of Tucson. The payback schedule for GO bonds ranges from 20 to 30 years.

Exhibit 9
Page 2 of 2

Capital Improvement Needs

Service Area/Department	Existing*			Future Growth-Related** (current \$)	Total
	Next Five-Years FY 05 - FY 09	Future Years	Subtotal		
Neighborhood Services	376,309.3	350,640.0	726,949.3	411,710.0	1,088,659.3
City Court	45,000.0		45,000.0	-	45,000.0
Community Services	18,700.0	-	18,700.0	-	18,700.0
Fire	30,000.0	-	30,000.0	70,250.0	100,250.0
Library	73,740.0	7,350.0	81,090.0	26,425.0	107,515.0
Neighborhood Resources	50,000.0	-	50,000.0	-	-
Parks and Recreation	113,869.3	343,290.0	457,159.3	301,635.0	758,794.3
Police	45,000.0	-	45,000.0	13,400.0	58,400.0
Environment and Development	992,587.3	2,043,152.0	3,035,739.3	1,531,845.0	4,567,584.3
Environmental Services	27,270.0	18,490.0	45,760.0	-	45,760.0
Transportation	965,317.3	2,024,662.0	2,989,979.3	1,531,845.0	4,521,824.3
Strategic Initiatives	11,425.0	-	11,425.0	30,000.0	41,425.0
Tucson Convention Center	11,425.0	-	11,425.0	30,000.0	41,425.0
Support Services	60,871.1	-	60,871.1	26,299.6	87,170.7
Development Services	1,000.0	-	1,000.0	-	1,000.0
Operations	59,871.1	-	59,871.1	26,299.6	86,170.7
Non-Departmental	117,605.0	-	117,605.0	-	117,605.0
General Expense	117,605.0	-	117,605.0	-	117,605.0
	1,558,797.7	2,393,792.0	3,952,589.7	1,999,854.6	5,902,444.3

Tucson Water	86,072.0	108,055.0	194,127.0	988,272.0	1,182,399.0
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Service Area	Existing			Future Growth-Related (current \$)	Total
	Next Five-Years FY 05 - FY 09	Future Years	Subtotal		
Neighborhood Services	376,309.3	350,640.0	726,949.3	411,710.0	1,088,659.3
Environment and Development	992,587.3	2,043,152.0	3,035,739.3	1,531,845.0	4,567,584.3
Strategic Initiatives	11,425.0	-	11,425.0	30,000.0	41,425.0
Support Services	60,871.1	-	60,871.1	26,299.6	87,170.7
Non-Departmental	117,605.0	-	117,605.0	-	117,605.0
	1,558,797.7	2,393,792.0	3,952,589.7	1,999,854.6	5,902,444.3

* The projects are spread over multiple years based on estimates of the work that could be accomplished if all needs were fully funded.

** Estimates of future needs based on population projections.

REVENUE ISSUES FOR CONSIDERATION: Review Exemptions to the City's Business Privilege Tax

Background: All Arizona cities and towns that collect a local business privilege tax do so through the Arizona Model Cities Tax Code. This common code provides a standard implementation of the business privilege tax across the state, while allowing local control through specific local exemptions that a city or town may employ. The local government implements an exemption by either setting a zero percent tax rate for the activity it wants to exempt or invoking the exemption.

Discussion: The City has decided to invoke some of the local exemptions allowed in the tax code. The Mayor and Council recently decided to change one exemption, the use tax, and begin collecting this tax.

Two other exemptions that the City still employs, residential rentals and local advertising, could provide significant revenue (see the following financial analysis). Even though there have been some discussions about these exemptions, Mayor and Council has not formally reviewed them.

The estimated revenue from a rental tax is \$12.4 million per year; the estimated revenue for a tax on advertising is \$3.6 million a year. The committee could consider recommending a formal review of the exemptions to the Model Cities Tax Code that the City currently employs.

Financial Analysis: Residential Rental Occupancy Tax

Prior to 1978, the City imposed a 2% business privilege tax on residential rentals. In 1979, the Mayor and Council exempted residential rentals from City sales tax. The exemption was phased in over two years.

What may have contributed to the decision to exempt residential rentals is that the assessment ratio (which determines the taxable value) was 40% higher for residential rental property than for owner-occupied property at that time. This resulted in a higher property tax on rental properties and it was assumed that the property tax would be passed on to the renter. Moreover, a homeowner could claim property tax as an income tax deduction, but there was no corresponding relief for renters.

The State has since equalized the assessment ratios at 10% for both owner-occupied and residential rental property. Renters are, in addition, granted an adjustment in State income tax.

All major Arizona cities impose a sales tax on residential rentals except Flagstaff and Tucson. This tax can be imposed by ordinance. **The estimated annual revenue is \$12.4 million per year.**

Financial Analysis: Business Privilege Tax On Advertising

Prior to 1992, the City imposed the two percent business privilege tax on advertising. In 1992, the Mayor and Council decided to exempt advertising from the tax, phasing the exemption in over two years.

The State does not tax advertising. However, all other Arizona cities that collect a business privilege tax include advertising.

Implementing the tax would require an ordinance.

The estimated annual revenue is \$3.6 million.

This analysis assumes a two percent growth rate from 1992 to the present and assumes that the structure of the industry has not changed.

Exhibit 11

REVENUE ISSUES FOR CONSIDERATION: Establish a Formal Policy for Implementing User Fees

Background: Three City services are provided on a full cost-recovery basis: water, golf and commercial sanitation. Other services require a user fee that covers a portion of the total cost of service provision: solid waste collection, recreation programs and building permits. Even though the City has some user fees, there is no formal user fee policy to guide the decision of when a fee is to be implemented.

Discussion: Local governments are increasingly looking to user fees to help support some services. Some local governments have adopted formal fee policies that guide the fees to be charged for specific services. MAXIMUS Financial Consulting has developed a pricing policy decision tree to help local governments evaluate when user fees would be appropriate.

Exhibit 12

National Trends in Waste Reduction

Fee type	No fee		Pay-as-you-throw					Flat Fee		
City	Tucson	Houston	Austin	San Jose	Seattle	Scottsdale	Mesa	Bellevue	Phoenix	Tempe
Population (2000)	486,699	1,963,631	656,562	916,488	563,374	215,080	440,404	109,569	1,321,045	159,220
Residences serviced	135,000	388,974	136,200	197,045	147,875	66,000	99,000	44,387	295,950	30,667
Garbage										
Fee: \$ per unit/mo	n/a	n/a	\$11.75/30 gal \$14.50/60 gal \$17.25/90 gal	\$16.80/32 gal \$33.60/64 gal \$50.40/96 gal	\$12.35 20 gal \$16.10/32 gal \$32.20/64 gal \$48.30/96 gal	\$14.36/90 gal \$21.40/2 containers (3)	\$18.64/90 gal \$8.80/2nd 90 \$16.64/60 gal	\$15.33/32 gal \$22.27/60 gal \$28.81/90 gal \$8.42/2nd 90	\$20.70/90 gal	\$13.96/90 gal
Container Rental Fee								\$0.56 - \$1.67		
Method of Collection	auto	auto	semi	manual/semi	manual/semi	auto	auto	manual/semi	auto	auto
Frequency (collections per week)	1	1	1	1	1	1	1	1	1	1

NOTE: Private hauler fees in Pima County range from \$12-18/mo.